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SUBJECT: Argentina's New Economy Minister Faces Daunting Policy Challenges

Ref: (A) Buenos Aires 1360
(B) Buenos Aires 1496
(C) Buenos Aires 1545
(D) 06 Buenos Aires 1732

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Summary

1. (SBU) Incoming Economy Minister Martin Lousteau will replace Miguel Peirano following the December 10 inauguration of President-elect Cristina Fernandez de Kirchner (CFK). The new Minister is a well-regarded 36-year old banker whose poise, intelligence and discretion reportedly caught CFK's eye. However, his youth, the subordination of his two predecessors to President Kirchner, and the Kirchners' apparent decision to directly appoint key second-tier Economy Ministry officials have raised questions about the degree of autonomy Lousteau will be granted to tackle pressing economic priorities, including accelerating inflation. Lousteau has already traveled to Brazil with president-elect CFK and was included in a meeting the Kirchners and Cabinet Chief Fernandez held with visiting German Economy Minister Michael Glos, but he has made no public statements. Nevertheless the youthful and photogenic Minister has been the "news" in the incoming cabinet lineup. Discussion of a possible Lousteau Economy Ministry agenda has served as a proxy for a debate on how and how quickly the CFK administration will address inflation and other macro and micro policy disequilibria. It is expected that Lousteau will start out by engineering a fiscal adjustment to help cool down the economy; negotiating a near-term informal rescheduling of Paris Club arrears; taming inflationary expectations via "social pact" negotiations with labor and industry; and repairing national statistics agency INDEC's tarnished credibility via a gradual normalization of its reporting of CPI inflation (though there is much uncertainty about his influence over INDEC at present.)

End Summary.

Lousteau: New Economy Minister to Replace Peirano

12. (SBU) In the aftermath of October 28 elections, it was widely speculated that low-key Economy Minister Miguel Peirano, who had replaced disgraced Minister Miceli July 17 (Ref A), would be retained by CFK. Peirano was supported by major industrialists to whom he had committed to sustain a rigorous domestic industry promotion/protection policy (Ref B). However, during the week of Nov 11, media reported that Peirano had conditioned his continued tenure on the removal of Internal Commerce Secretary Guillermo Moreno, who had frustrated Peirano's attempts to regain Economy Ministry control over discredited national statistical agency INDEC (Ref C). While Moreno notionally reports to the Economy Minister, he is widely known to answer directly to President Kirchner and to Planning Minister Julio de Vido, who have supported Moreno's heavy handed enforcement of price controls

13. (SBU) Peirano's demand became fodder in a battle between De Vido and Cabinet Chief Alberto Fernandez. This embarrassing cabinet fight, along with domestic and international capital market nervousness over Argentina's future economic policy direction prompted the Kirchners to accelerate the announcement of key cabinet positions. On November 14, Lousteau was chosen from a field of candidates that was reported to include national revenue agency director Abad, former Central Bank President Blejer, current Central Bank President Redrado, Kirchnerist Congresswoman Marco del Pont and Investment Promotion Agency Director Nofal.

How Much Autonomy Will Kirchners Allow Lousteau?

14. (SBU) At 36, Lousteau will be Argentina's youngest ever Economy Minister. He is considered both academically qualified and professionally capable given his prior work as Province of Buenos Aires Production Minister and, most recently, as head of Banco de Provincia de Buenos Aires (See bio para 12.) However, Lousteau's youth and the involvement of President Kirchner in every aspect of Argentine economic policy formulation have caused many to question the degree of autonomy he will be granted and his ability to influence incoming President CFK. Moreover, his apparent willingness to accept the Kirchners' control over key second-tier Secretary-level appointments -- appointments normally made directly

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by the Economy Minister - have led some local analysts to see Lousteau as a subordinate cabinet member who will allow the Presidential couple to directly manage key economic policy decisions. Others hold out hope for a positive evolution over time.

15. (SBU) Embassy contacts report that the key Economy Ministry Secretary of Hacienda position (the GoA's OMB-equivalent lead on

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budget development) has been reserved for Kirchner loyalist and current ENARSA president Juan Carlos Pezoa. The budget process remains crucial to what many here see as the Kirchners' intent to weaken the traditional federalist autonomy of provincial governors and further concentrate political power at the federal level. Controversially, over the past four years, Kirchner presidency budgets have significantly understated anticipated revenues and so allowed the executive to utilize current "superpower" authority to directly allocate over-budget revenues without parliamentary oversight (Ref D). These superpower revenues have often been allocated to provincial public works projects and to provincial budget support in ways many interpret as patronage designed to enhance the Kirchners' political influence over provincial governors.

Lousteau's Policy Priorities: Local Speculation

¶6. (SBU) Lousteau has already traveled to Brazil with president-elect CFK November 19 and was included in a meeting the Kirchners and Cabinet chief Fernandez held with visiting German Economy Minister Michael Glos November 21. But he has been very careful to make no public statements on his policy priorities before taking office. As a result, just what policy views Lousteau will bring to the Economy Ministry and just how much room to maneuver he will be granted by CFK has been the subject of intense media speculation. In the absence of clearer economic policy signals from CFK, discussion of a possible Lousteau agenda has served as a proxy for a debate on how and how quickly the CFK administration will address inflation and other macro and micro policy disequilibria that threaten Argentina's soft landing to sustainable GDP growth in the 5-6% range.

¶7. (SBU) For example, shortly after Lousteau was named, considerable media attention was given to an economic policy proposal -- incorrectly attributed to Lousteau -- that was presented to CFK by outgoing Buenos Aires province Governor Sola. Key components of this plan included linking the peso to a trade-weighted basket of currencies and offering holders of some \$20 billion in "holdout" debt a debt for equity option whereby holdouts who agree to invest in Argentine fixed productive capital would receive a sweetened payout option. Finally, after a week of silence by Lousteau, the plan was attributed to Eugenio Diaz Bonilla, Argentina's IDB Executive Director based in Washington.

¶8. (SBU) Most local analysts agree that Lousteau will with an action agenda of: (1) engineering a fiscal adjustment to help cool down the economy; (2) negotiating a near term informal rescheduling of Paris Club arrears; (3) taming inflationary expectations via "social pact"

negotiations with labor and industry; and (4) repairing INDEC's tarnished credibility via a gradual and politically palatable normalization of INDEC's reporting of CPI inflation. On the fiscal adjustment, Lousteau should be able to count on support from CFK: in her campaign speeches, she referred a number of times to her intent to boost Argentina's primary fiscal surplus from the 3% range in 2007 (more accurately 2.0-2.5% after discounting one-off factors) to the 4% range. Market players here expect Lousteau to work to deliver a 1.3 - 1.5% of GDP fiscal adjustment through a combination of reduced subsidy payments (via public utility price adjustments); work with the Planning Ministry to slow disbursements on non-priority (read non-energy) public works projects; and via increased revenues linked to increases in export tariffs on primary commodities. Most local analysts call such fiscal tightening welcome given dramatic pre-election increases in public spending (public spending rose by over 54% year-on-year in the first nine months of 2007 while revenues rose 42% during this period).

¶9. (SBU) On managing Argentina's foreign debt profile, Lousteau is expected to work with Central Bank President Redrado to smooth the maturity profile of Argentina's foreign and domestic debt portfolios and to seek capital market opportunities to obtain the roughly US\$ 7 billion in projected 2008 refinancing needs at the lowest possible cost. Lousteau is also expected to engage early on the Paris Club settlement issue, given the prospect of a near-term payback in the form of needed official export credit agency financing. Finally, Lousteau is known to be an advocate of a "competitive" (i.e., weak) peso, but he is expected to argue against further weakening the currency from current levels given the risk of further stoking inflation. In any case, currency management remains under the control of Central Bank President Redrado and of President Kirchner, and Lousteau is unlikely to be given much weight in deciding how to fine-tune exchange rate policy.

¶10. (SBU) Inflation remains a principal challenge for Lousteau. Though official INDEC data puts annual inflation at around 9%, private estimates suggest that "real" rates are in the 17-20% range. Others, including Central Bank experts, estimating true inflation somewhere in between official and independent estimates. Strong post-election increases in food, fuel, transport, health care and education prices have again raised public concerns over this issue. However, CFK's pre-election statements that inflation rates are "reasonable" in a context of high growth, her rejection of policy criticisms, and the GoA's unwillingness to tighten monetary policy

make it unlikely that Lousteau will be granted the opportunity to initiate any radical change in approach. Given this, Lousteau's inflation fighting efforts will likely focus on implementing CFK's "social pact," which are expected to involve sector-by-sector negotiations between the GoA, business and trade unions, aimed at fixing wage and price rises over a three-year period based on 2007 inflation. However, union doubts over official inflation data -- expressed regularly in public -- undermine prospects for such a deal. Industry also rejects any fixing of prices for the same reason, arguing that their input costs are rising and demanding that productivity be factored into any negotiations, a condition rejected by labor.

¶11. (SBU) Finally, Lousteau is expected to attempt to improve INDEC's statistical reporting gradually and in a way that doesn't confront Internal Commerce Secretary Moreno (who reportedly will stay on in his position) and provoke the type of political tensions that led to Peirano's early resignation. The current (and controversial) head of INDEC's CPI unit, Beatriz Paglieri, who recently traveled to Washington to research U.S. CPI methodologies, had previously worked for Lousteau as Province of Buenos Aires Production Ministry Secretary for International Relations. INDEC workers continue to stage public protests with regularity and press articles focusing on doubts about IDEC figures continue to appear each week.

Bio Data

¶12. (U) Lousteau has served as President of the state-owned Banco Provincia de Buenos Aires since December 2005. Previously, he worked as Province of Buenos Aires Minister of Production (August-December 2005) and as Chief of Cabinet of the Buenos Aires Province Ministry of Economy (July 2004-August 2005) under Governor Felipe Sola. From 2003-4, Lousteau worked at the federal Central Bank under Governor Alfonso Prat-Gay and Vice Governor Pedro Lacoste. From 1997-2002, he worked at the APL economic consulting firm with Prat-Gay and Lacoste and at the Grupo Unidos del Sur, an NGO dedicated to implementing government reforms created by Francisco de Narvaez, who in 2007 came in third in the race for governor of Buenos Aires province. While working at Unidos del Sur, Lousteau co-wrote "Sin Atajos" (Without Shortcuts) with Javier Gonzalez Fraga, former Central Bank Governor during the Menem administration and 2007 presidential candidate Roberto Lavagna's pick for his own Economy Minister. The book calls for an end to "magic economic formulas" and a focus on developing state economic institutions as the best means to address Argentina's historical economic volatility. Lousteau was a Professor of Economics at the prestigious Torcuato Di Tella and San Andres Universities. He holds a BA in Economics (Summa Cum Laude) from San Andres University and a MA in Economics from the London School of Economics.

Comment

¶13. (SBU) The longer a CFK administration takes to address growing economic disequilibria, the more costly -- economically and politically -- their correction will be. CFK is set to begin her presidency on the downslope of GDP growth trends at a time when foreign and domestic private sector investment needed to sustain growth is increasingly constrained by concerns over the economic policy environment, and as uncertainty and risk aversion is on the rise internationally. It is encouraging that CFK has turned to a technically capable economist/banker to face these challenges, but serious questions remain about whether Lousteau will be given free enough reign to do the right things.

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